No. 14,402

IN THE

United States Court of Appeals

For the Ninth Circuit

OTIS A. KITTLE,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

Upon Appeal from the Tax Court of the United States.

REPLY BRIEF OF APPELLANT.

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Respondent is wrong in saying (Br. p. 13) that "it is perfectly clear that the payments here sought to be treated as gain from a sale were intended by the parties, in the ordinary course of mining under the lease, to be measured by the production and shipment of ore." We think the opposite is the fact. The payments in question (year 1946) were fixed in dollars in the amended lease, whether or not ore would be produced and shipped in that year. Such payments constituted parts of the purchase price for mining rights to remove a stated tonnage of ore, namely, twenty million tons. We respectfully submit that it is not a minimum royalty.

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As we understand minimum royalty provisions in mining leases, the penalty for a lessee's failure to pay the minimum royalty is loss of the lease; there is no right of action by the lessor against the lessee for the unpaid portion of the minimum royalty. Therefore, a minimum royalty provision is clearly distinguishable from the personal and continuing corporate liability under our lease. Lessee in our case is bound to pay whether it keeps or loses the lease, and such obligation subjects all other assets of lessee to the danger of execution at the instance of lessors.

There is another distinction between a minimum royalty clause and the provision in our lease. Under our lease, mineral rights to twenty million tons have been sold by lessors to lessees for ten million dollars. Suppose it is discovered that twenty million tons of ore do not exist in the leased premises or that much less than such tonnage is commercially usable to justify the cost of mining it. As we see it, lessee is still absolutely bound to pay the total of ten million dollars. In that event, the cost of a ton of the mined ore is not fifty cents, (treated on a royalty basis) but ten million dollars divided by the number of tons actually mined and removed. So, it cannot be said that the term "royalty" is appropriate when referring to the twenty million tons or to the payments made in 1946 or any other year for part of the twenty million tons.

We agree with respondent (Br. p. 10) that the name used by the parties in describing the contract

does not necessarily determine its nature. Although paragraph 6 of the amended lease (Tr. p. 34) refers to royalty on the first twenty million tons, the intention of the parties as shown by the other provisions of the lease seems clear to the effect that the ten million dollars is an amount of money payable without regard to royalty.

There are obvious differences between the 1899 lease and the 1946 amended lease. The first lease contained a clause requiring lessee to mine and ship 200,000 tons annually or to pay as "advance royalty, to be treated and considered as ground rent" a sum which added to the royalty on mined ore would make $50,000. Failure to do so would be only a cause for termination. There was no personal or continuing corporate liability to pay and, moreover, such payment was stated to be ground rent. That first lease also provided that it could be terminated by the lessee on notice of thirty days and there was no provision to permit lessors to seek payment of that "ground rent" from other corporate assets. How, then, can respondent say (Br. p. 14) that appellant has failed to point out any significant departure in the amended lease, from the old 1899 lease, which would call for a result differing from the Tax Court's conclusion in *DeVelin v. Commissioner,* 22 B.T.A. 1400?

Respondent suggests (Br. p. 13) the possibility that in event of termination of the lease the lessee might never be able to get all or a part of the ore. Surely that possibility cannot have any bearing here favorable

to respondent. There is no provision in the amended lease that makes it impossible for lessee to mine and ship the entire twenty million tons. Lessee is liable unquestionably for the ten million dollars. Failure to take the full tonnage will not be due to any act of lessors but will be solely attributable to lessee itself and it will not be because of any retention by lessors of title or economic interest. If it should be that the entire twenty million tons are not mined and taken by lessee, it will be because lessee elects to abandon something it has already purchased or there is not that much merchantable ore. Such abandonment is not unknown to the law.

In the cases cited by respondent there was no provision in the lease similar to these words in our lease: "such obligation is hereby assumed and agreed to be paid as a continuing corporate obligation of said lessee." In those cases the lessor looked to the ore and the royalty due upon its extraction from the ground. That distinction is pointed out in the *Anderson* and *Elbe* cases, discussed in our opening brief.

Dated, Reno, Nevada,
May 4, 1955.

Respectfully submitted,
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